Office of Chief Counsel
Internal Revenue Service

memorandum

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to: William Kennedy, Manager, Group 1282, M/S 4201PHX
Attn: Vickie Kearon

William H. Jonas, Engineer
Engineering Group 1856, LMSB

from: Office of Chief Counsel, Phoenix
LMSB:NR, Area 4

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subject: [redacted]
Charitable contribution of [redacted] collection

DISCLOSURE STATEMENT

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This advice is not binding on Collection, Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.

ISSUE

What criteria should govern the amount of the taxpayer's charitable deduction for its contribution of certain materials to the [redacted]?

CONCLUSION

If the Service wishes to disallow any portion of the claimed deduction on grounds other than valuation, it should be prepared to demonstrate that such materials constitute advertising materials in the hands of the taxpayer.

FACTS

In [redacted], [redacted] entered into an asset purchase agreement with [redacted]. Under this agreement, [redacted] purchased all tangible and intangible assets utilized in or associated with the seller's [redacted] line of business for a purchase price of $[redacted]. Of this amount, the parties allocated only $[redacted], with that amount allocated to covenants not to compete. In [redacted], [redacted] and the Service entered into a closing agreement in which $[redacted] was allocated to trademarks, patent intangible, package design intangible, covenant not to compete intangible, and goodwill or going concern value. The Service is not aware of any allocation of the remaining $[redacted] of the purchase price.

The assets purchased included "[redacted] Business advertising and promotional materials... ." These materials included materials created from as early as the [redacted]'s in connection with [redacted]'s long-running "[redacted]" campaign. In [redacted], the taxpayer decided to display portions of these materials in its building, and had these materials appraised for insurance purposes at that time. As of [redacted], the collection was valued at $[redacted]. The taxpayer also briefly revived the "[redacted]" campaign during [redacted] so that the advertising materials now consist of the original materials as well as additions to the collection.

On [redacted], the taxpayer donated both the original collection and the additions to the collection to the [redacted]. The taxpayer at that time obtained an appraisal of the original collection and additions to the collection at $[redacted]. This appraisal was performed by the same appraisers who prepared the [redacted] appraisal. Based on such appraisal the taxpayer has claimed a charitable deduction in the amount of this second appraisal.

You are concerned that the taxpayer's failure to expressly allocate any portion of the purchase price to these materials gives the taxpayer an unwarranted benefit. It is possible, for example, that the taxpayer has implicitly allocated a portion of the price to the original collection as advertising materials, and has deducted them accordingly. It is also possible that no

part of the purchase price was allocated to the collection in spite of its value, and that if such items constitute artwork, then the taxpayer's allocation of the value of the original collection to other items resulted in excess deductions over the years. You have therefore asked how all these factors should affect the Service's approach to this case.

DISCUSSION

As you have noted, this matter is complicated by the fact that the original collection was created over a period of years for the purported purpose of promoting a specific product, so that the original cost of these materials should have been deducted long ago under the principles set forth in Treas. Reg. § 1.162-1(a). Under these provisions, advertising and other selling expenses are generally deductible at the time incurred. Thus, in the hands of the entity that originally caused the creation of these advertising materials, I.R.C. § 170(e)(1)(A) would presumably have the effect of allowing no amounts as a charitable deduction. This section generally provides that the amount of a charitable deduction is reduced by the amount of gain which would not have been long-term capital gain if the property had been sold by the taxpayer at its fair market value. Since the cost of such advertising was all currently deductible in the year of its creation, and since the such taxpayer would therefore have no basis in the property, then all such proceeds from a hypothetical sale would have constituted ordinary income. Under such a scenario, no amount would be allowable as a charitable contribution deduction.

The present situation, however, is not so clear. For example, the original collection has arguably elevated from the lowly status of "advertising materials" to the more prestigious status of "art" or "collectible." Much as advertising trays from the early twentieth century are sought after by collectors, who would have capital gain income upon the sale of a greatly appreciated piece in their collection, the taxpayer likely believes that the public is interested in the original collection for something more than its original purpose as advertising. Thus, if the taxpayer treated such objects as something other than ordinary income property (as advertising created by the taxpayer would be), then the deduction should be in the amount of the property's fair market value.

In that regard, you have proposed three possible approaches to this issue, and have requested our thoughts on the merits of each. The first such approach would treat the donation to the [redacted] as having a promotional intent, for which any deduction should be limited to the taxpayer's basis ($0) as

advertising expenses. Under such theory, the contribution would not have had a donative intent, but instead would have been for the purpose of enhancing and continuing the exposure of the collection as promotional material. See Treas. Reg. § 1.170A-1(c)(5), regarding expectation of financial return commensurate with the amount of the transfer. [redacted]. The taxpayer certainly received some amount of positive publicity from this transfer, as evidenced by the recent [redacted] article in the [redacted] magazine. This by itself, however, should not remove this transaction from the category of charitable contribution. Indeed, positive publicity often accompanies good deeds, and [redacted].

[redacted]. For example, in Transamerica Corp. v. United States, 902 F.2d 1540 (Fed. Cir. 1990), the taxpayer transferred original and deteriorating film stock to the Library of Congress, after which the recipient was to spend substantial sums converting such film stock to safety film, and the taxpayer was to retain exclusive access to the safety film for commercial purposes. In that situation, the taxpayer for all practical purposes gave away nothing, since it retained exclusive access for commercial purposes, and received substantial benefit, in the form of a free restoration. While this office does not purport to have knowledge as to the value of such film, we would expect that the value of film requiring such expensive restoration would be rather low. In the present case, the taxpayer gave up something of possible, although debatable, value, the possession of and ability to display on its premises the collection. We assume that it also gave away its right as owner to sell all or part of the collection, which if the appraisals are to be believed, constituted a valuable right. Other factors are not obvious to us at this point. For example, [redacted]? If this is the case, and the collection is viewed as advertising rather than art, [redacted]. Similarly, [redacted]? If, for example, the taxpayer spent substantial advertising moneys during this period featuring the transferred

goods and some sort of tie-in with the [redacted] (b)(7)a [redacted].

That brings us to your second suggested approach, that the charitable deduction should be limited to appreciation of the collection since [redacted], the date it was acquired by the taxpayer. (b)(7)a [redacted]. The taxpayer likely applied what should have been the basis of this asset to other property, which it has probably been depreciating or deducting over the years; (b)(7)a [redacted]. This method would prevent a double deduction without the need of revisiting the $[redacted] not designated by the parties in [redacted] or by the Service and the taxpayer in the closing agreement, along with the related valuations placed on specific items in [redacted] by the taxpayer.

You acknowledge, however, that such a disallowance as a double deduction would be dependent on the original collection constituting advertising materials for tax purposes. See, e.g., Rev. Rul. 82-9, 1982-1 C.B. 39, in which the taxpayer attempted to take a charitable deduction for which the costs related thereto had been previously expensed, and any income from a hypothetical sale would have been ordinary rather than capital. (b)(7)a [redacted]. While the additional collection created by the taxpayer around [redacted] almost certainly constitutes advertising materials, the original collection might constitute either depending on the taxpayer's use of such materials. If the taxpayer merely displayed them in its building, with no plans to revive the campaign, then the collection is likely artwork; if the taxpayer used such materials extensively in its campaigns, then that might change its character. This might then lead to another factual issue regarding when such an "advertising intent" arose. (b)(7)a [redacted].

(b)(7)a [redacted]

(b)(7)a

(b)(7)a

. In the revenue ruling discussed above, the important fact appears to be the taxpayer's deduction of the same item twice; in the present case, there may be an inappropriately large amount, for example, deducted for office equipment, followed by the charitable contribution. (b)(7)a

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Please be advised that we consider the statements of law expressed in this memorandum to be significant large case advice. We therefore request that you refrain from acting on this memorandum for ten (10) working days to allow the Division Counsel (Large and Mid-Size Business) an opportunity to comment. If you have any questions regarding the above, please contact the undersigned at (602) 207-8052.

JOHN W. DUNCAN
Attorney

cc: Division Counsel, (Large and Mid-Size Business)